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November 2, 1994

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street NW
Washington, D.C. 20554

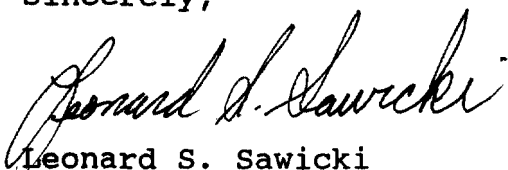
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Re: CC Docket 94-1; Price Cap Performance Review for
Local Exchange Carriers

Dear Mr. Caton:

Today, members of Customers for Access Rate Equity (CARE) met with members of the Common Carrier Bureau staff. Representing CARE were Frank Fletcher (Ad Hoc Telecommunications Committee), Richard Clark and Paul Malandrakis (AT&T), Doug Jarrett (API), Brian Moir (ICA), Bradley Stillman (CFA), Genny Morelli (CompTel) and me. We met with Kathleen Wallman, Kathleen Levitz, Richard Metzger, Mark Uretsky, Dan Grosh, David Nall, Geraldine Matise and Anna Gomez. The purpose of the meeting was to review CARE's views on this proceeding. The attached information was used during the meeting and the specific topics discussed are listed there.

Sincerely,


Leonard S. Sawicki

Attachment

cc: Ms. Gomez
Mr. Grosh
Ms. Levitz
Ms. Matise
Mr. Metzger
Mr. Nall
Mr. Uretsky
Ms. Wallman

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LEC PRICE CAPS: UNDERSTANDING AN \$8.2 BILLION ISSUE

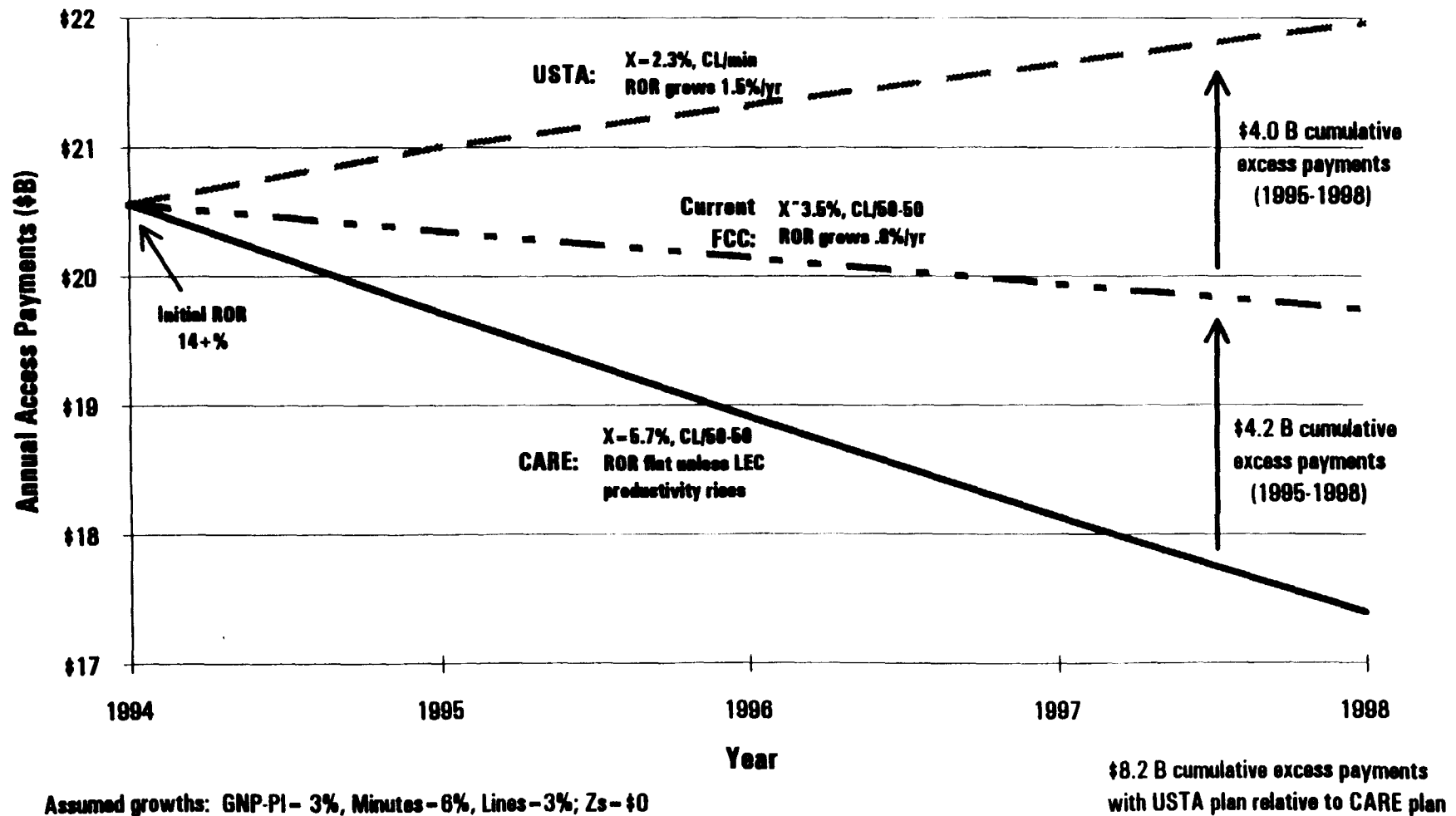
*CUSTOMERS FOR ACCESS RATE
EQUITY (CARE)*

NOVEMBER, 1994

CARE

- Customers for Access Rate Equity
- A coalition created to work for LEC price cap reform.
 - Ad Hoc Telecommunications Users Committee
 - American Petroleum Institute
 - AT&T
 - Consumer Federation of America
 - CompTel
 - International Communications Association
 - MCI
 - National Association of State Utility Consumer Advocates
 - WilTel

ANNUAL ACCESS PAYMENTS TO PRICE CAP LECs



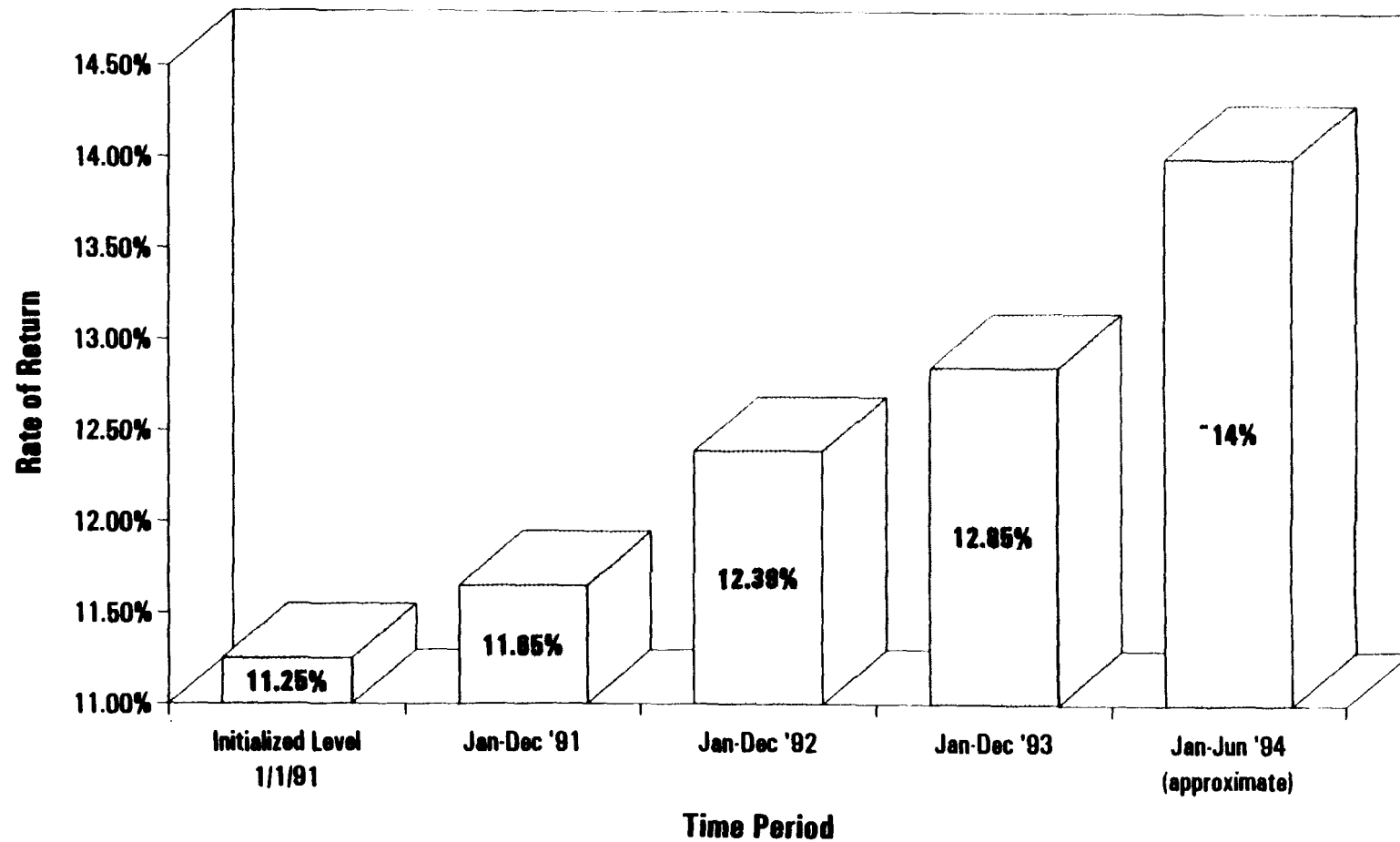
Introduction

- LECs have profited disproportionately from price caps.
- RBOCs have used proceeds for non-regulated ventures.
- FCC can resolve the current disparity between customers and the LECs:
 - Increase the productivity factor.
 - Adjust rates for lower cost of capital.
 - Decrease rates going into next price cap period.
 - Continue sharing.

LECs Have Profited From Price Caps At The Expense of Customers

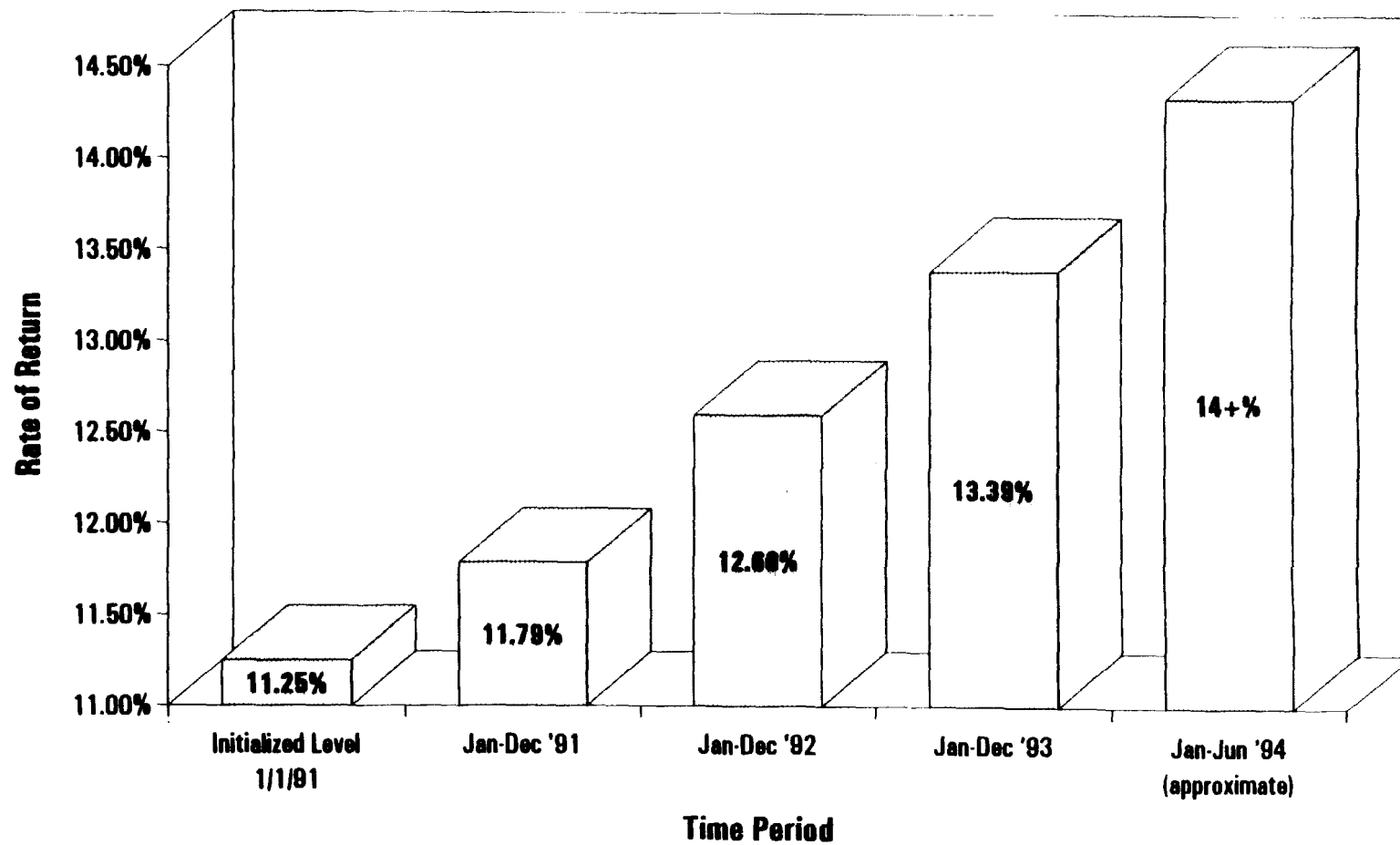
- Rates of Return Have Increased
- Cost of Capital Has Decreased
- Rate Decreases Have Not
Approached Those of The Pre-Cap
Era

PRICE CAP LEC INTERSTATE RATE OF RETURN: 1991-94



Sources: 1991-93 RORs from FCC Form 492 reports
1994 ROR estimated from FCC ARMIS 43-01 reports

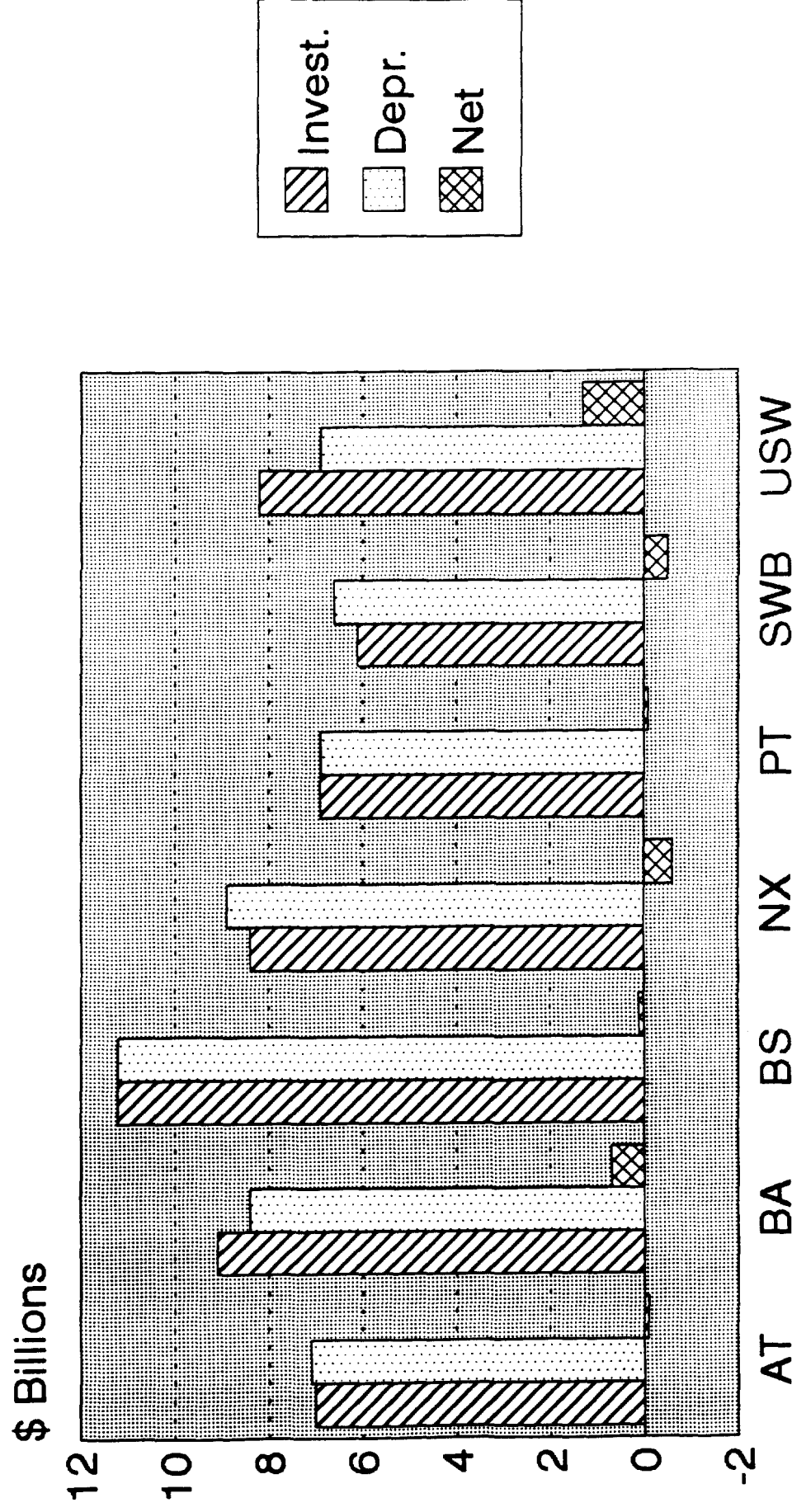
RBOC INTERSTATE RATE OF RETURN: 1991-94



Sources: 1991-93 RORs from FCC Form 492 reports
1994 ROR estimated from FCC ARMIS 43-01 reports

RBHC Investments In BOC Plant

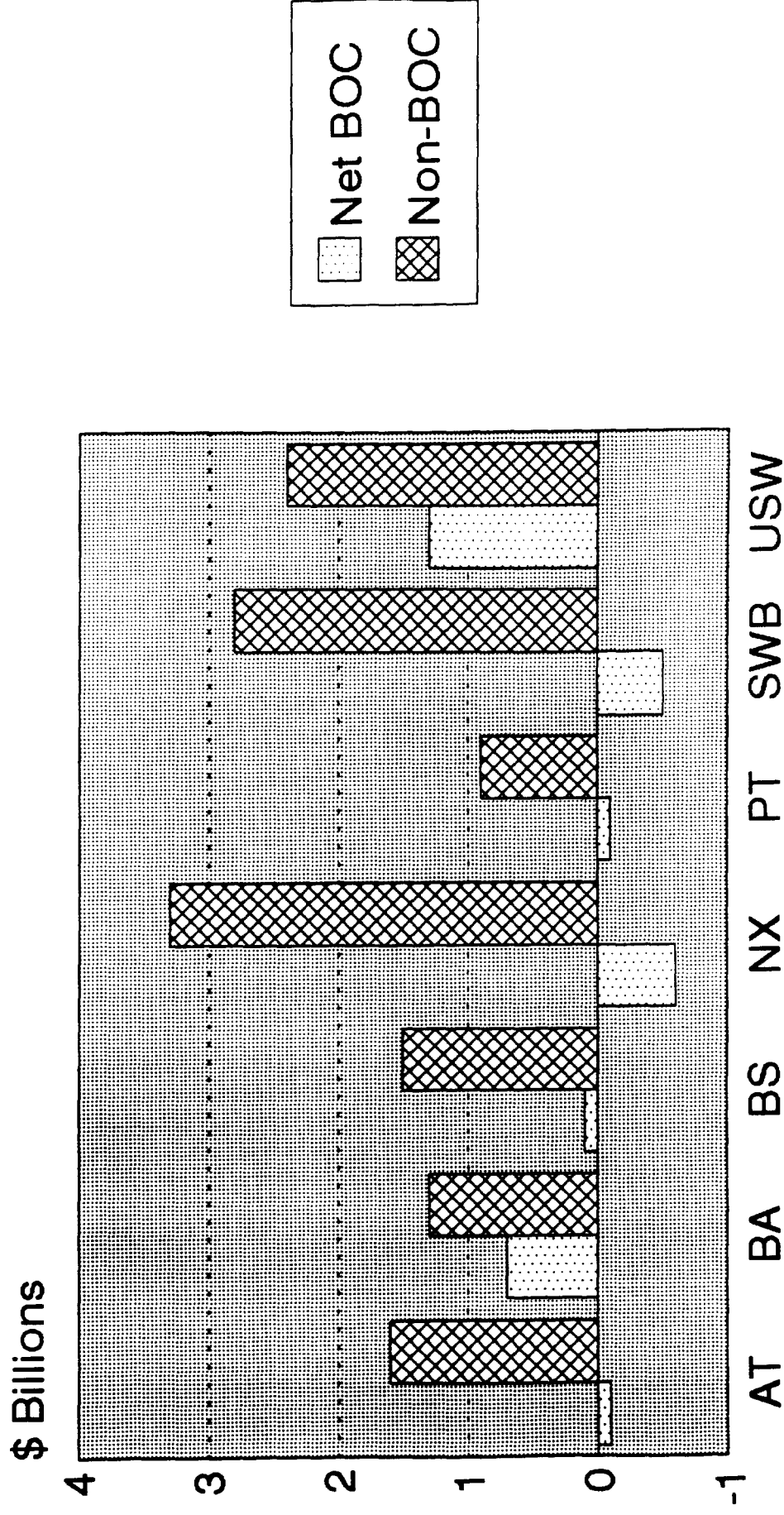
1990-1993



Source: ETI

RBHC Investments

1990-1993



Source: ETI

PRODUCTIVITY FACTOR MUST BE INCREASED

- Current factor was low end of range of FCC options
- In 1990, FCC chose "conservative" figure
- Experience shows FCC's initial reservations were unfounded
- 5.7% or higher factor amply supported in the record
- USTA study misapplies FCC/FU method

LEC "X" Should Be No Less Than 5.7%

- Matches 1991-94 LEC achieved rate of productivity (without the CPD)
- Matches LEC results for 1985-90 under rate of return plus a 0.5% CPD
- Still leaves LECs with \$2.9 billion in excess revenues from 1991-94

The Record on LEC Productivity

- Ad Hoc analysis of productivity and input prices shows X of 5.7% (including 0.5% CPD)
- AT&T Direct Model: 5.6% to 5.8%
 - Understates X: no correction for net demand repression due to excess LEC rates
- FCC Simple Model: 5.2% to 5.5%
 - Underestimated due to "below cap" pricing
 - Corrected per NERA
- MCI estimate: 5.9% using FCC short term method (no 1984)
- FCC study: Over 5% for 1985-90
- Christensen study: Implies 5.2% for 1984-1992
 - Adjusted for differential input price growth

The Record on LEC Productivity, continued ...

- Under price caps, LECs achieved productivity well over 5%, yet decreased rates based on 3.3% basis
- Returns grew 0.80% annually because of the difference between productivity and pricing
- If X not increased, return will continue to grow
- Continued disconnect between cost of capital and monopoly returns

The Record on LEC Productivity, USTA's Low Ball...

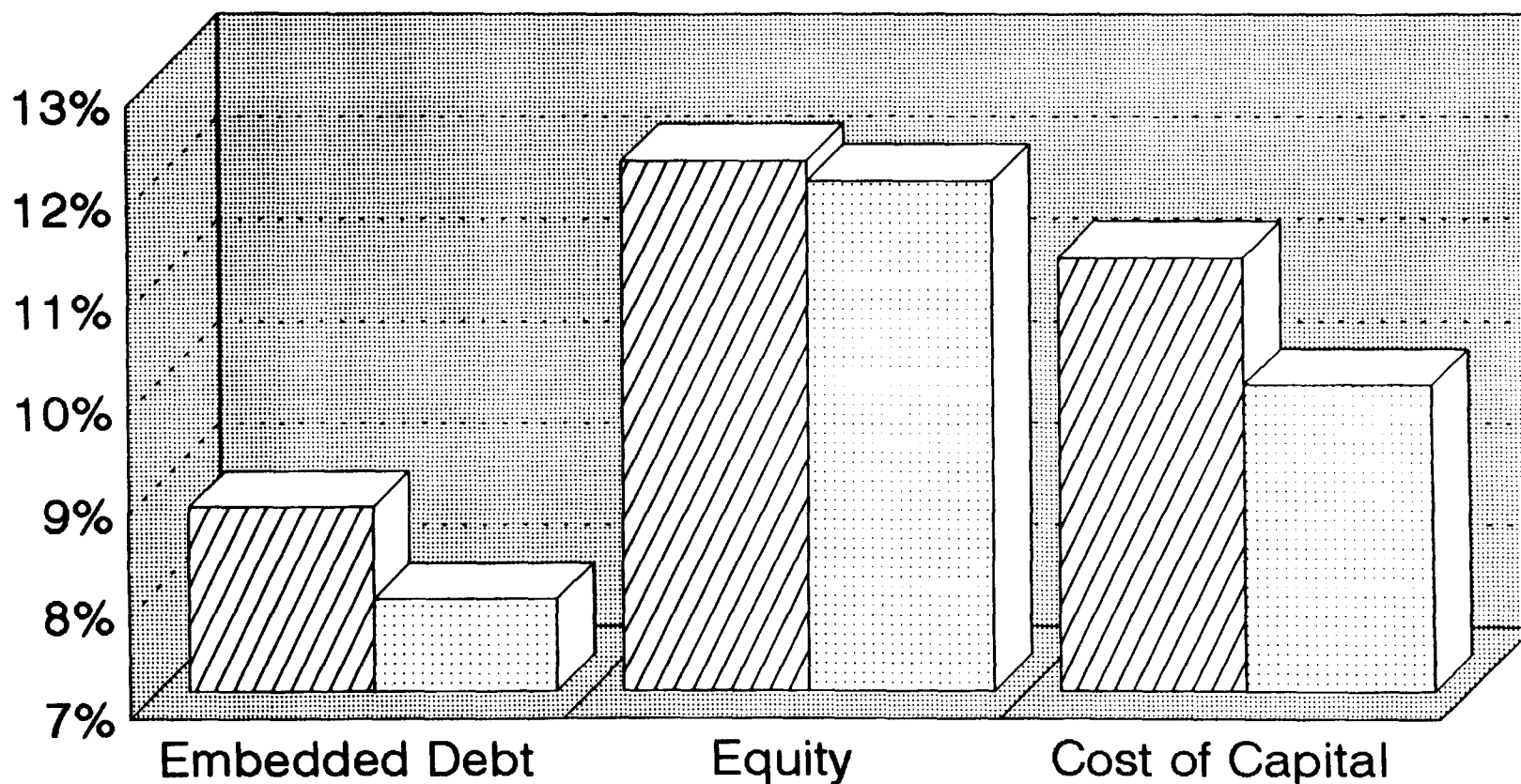
- USTA argues for a lower productivity estimate:
 - Shows productivity at 2.67%, and as low as 0.22% in 1991-92
 - LEC performance (returns, profits) contradicts contrived USTA numbers
- USTA number out of range of other estimates
 - X incorrectly calculated (wrong weights)
 - 1984 data point lowers X by about 2%
 - Data not just for price cap LECs
 - 1993-94 data neglected
 - Undocumented: results cannot be duplicated
 - Incorrect demand stimulation



LEC RATES MUST BE ADJUSTED TO REFLECT LOWER COSTS OF CAPITAL

- Current cost of capital is 10.0%
- 11.25% allowed now
- Much of cost of capital not captured in GNPPI-X (or GDPPI-X)

LEC Capital Costs

1990 and 1994

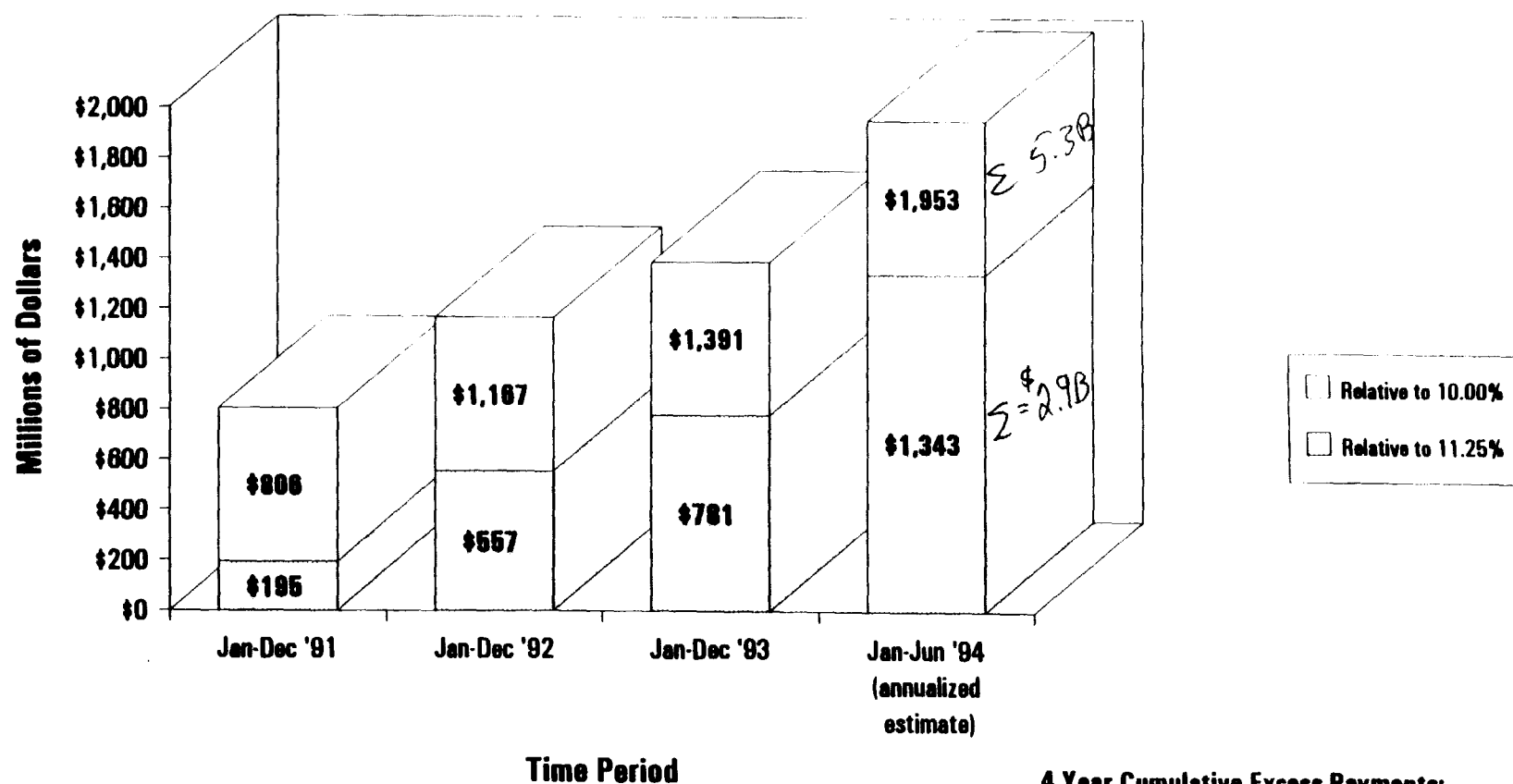


1990		8.8%	12.2%	11.25%
1994		7.9%	12%	10%

Rate Cuts, Reinitialization Are Needed

- Price caps have allowed cumulative excess revenue of \$2.9 billion
- LECs' annual revenues are now \$1.3 billion over an 11.25% return level
- LEC cost of capital is 10% -- \$600 million windfall vs. 11.25%
- Rate cut necessary to reflect FCC underestimates of LEC productivity

ANNUAL EXCESS PAYMENTS TO PRICE CAP LECs RELATIVE TO 11.25% AND 10.00% COST OF CAPITAL



4 Year Cumulative Excess Payments:
\$2.9 B relative to 11.25% cost of capital
\$5.3 B relative to 10.00% cost of capital

SHARING MUST CONTINUE

- Insurance against excessive monopoly rates.
- Increasing every year. 1994 value could exceed \$400 million.
- Only means to compensate ratepayers for LEC abuses of accounting and other rules.
- Fines are not a sufficient deterrent for enforcement of FCC rules.

Summary

- Productivity factor no less than 5.7%
- Cost of capital of 10.0%
- Adjust rates downward
- Keep sharing